THE NATIONAL CITY BANK OF NEW YORK

1933

Economic Conditions Governmental Finance United States Securities

New York, October, 1933.

General Business Conditions

THE upswing in business that is usually looked for after Labor Day has fallen short of hopes thus far, and measured against the normal seasonal movement September has been the second month of reaction from the peak of the recovery. Operations in a number of industries have slackened as compared with August. Steel ingot production dropped back to 41 per cent of capacity, compared with 59 the peak in July, before a check to the decline appeared. Railway carloadings show less than the usual seasonal increase, and the same is true of the production of coal, which had been speeded up during the Summer in anticipation of strikes and price advances, and the output of electricity, especially for industrial use. All these are good measures of general business, their activity reflecting conditions in varied lines.

The automobile industry made an exceptionally good showing in August by turning out more cars than in July, and has done well in September also. However, seasonal contraction in sales was overdue, and is now forcing some curtailment. In textiles, and likewise in the tire industry and others making articles of everyday use, a falling off in operations has been inevitable. Textile production during May, June and July, according to calculations by the Textile World, was 10 per cent above the 1919 boom level and 25 per cent above the average of 1924-31. Rubber consumption also broke records.

Naturally the consumer demand, in the present state of purchasing power, will not support production levels higher than ever before reached. These industries have had to curtail accordingly, though as a group they continue at a high rate, supplying the bulk of current business. The primary textile markets have had a moderate Fall pickup, sufficient to support current operations, and the situation in wool goods particularly continues strong.

Retail trade has slowed down. Beginning with May, retail sales had run ahead of the 1932 figures by a constantly increasing percentage, until in August department store sales in dollars were 16 per cent larger than one year previous. This increase was greater than the price rise, signifying a larger movement of merchandise. After Labor Day, however, reports turned less satisfactory, with sales slumping in many sections of the country. In New York City, during the first half of September, department store sales were 6½ per cent below 1932, and as prices were probably 15 per cent higher the volume of goods moved was obviously much smaller. Subsequent reports have been better, indicating that unfavorable weather and other temporary factors accounted partly for the decline. Nevertheless the figures for the month, especially as related to the volume of merchandise sold, are unquestionably disappointing, and business sentiment has been unfavorably affected.

Business men recognize that the ability of the public to pay higher prices at retail, as the higher wholesale prices and increased costs of retailing are passed on to the consumer, is the chief uncertainty in the N.R.A. program. If purchasing power fails to keep pace with the advance in prices the warning signs will quickly appear in the retail sales figures. There is also some fear that consumers, who have been on notice that prices are going up, are laying in supplies for future use, and accordingly may buy less later on when the real test of higher prices comes.

The Rise in Retail Prices

The rise in retail prices has proceeded rapidly. According to the Fairchild index of department store prices, which is based on information from stores over the country, the advance from May 1 to September 1 was 18.8 per cent, the increase each month having been at an accelerating rate, as follows: May 1.4 per cent; June 2.6 per cent; July 5.2 per cent; August 8.4 per cent.

This advance is certain to continue, since stores still have low-priced goods on hand and

have by no means marked up their stocks to the current replacement basis. Household supplies of slow turnover, such as china and glassware and electric appliances, have been advanced very little. The textiles generally have been marked up most, with cotton wash goods up 36 per cent, but silk and woolen fabrics and many items of apparel are out of line with replacement costs. Men's suits in some instances were selling at retail on September 1 for less than they could be bought at wholesale. It is the opinion of Mr. A. W. Zelomek, who compiles these indexes, and of other authorities, that when prices are marked up to a replacement basis the advance from the low point will approximate 35 per cent, which should come by the end of Fall or early Winter.

A factor in the rise is that retailers' markup must be increased to absorb their higher costs under the code, and also to offset reduction or elimination of display and advertising allowances, and quantity and cash discounts, where required by manufacturers' codes. This should be remembered in case the price advances required by these new conditions bring out charges of profiteering, which are a familiar accompaniment of rising costs of living. There is abundant evidence that retailers are endeavoring to move all the goods they can, which requires them to keep prices as low as they can, and in fact competition assures that they will do so. Nevertheless retail prices must bear the burden of higher raw material prices, of the processing taxes (in the case of the farm products affected), of the increased costs of each manufacturer and distributor in the chain between the farmer and the retailer, and finally of the increased retailing costs themselves. This is a formidable burden, all of which the consumer must bear, for the argument that there is a margin out of which any substantial part of these costs can be met is not supported by the earnings reports of the industries or businesses concerned. As for the possibilities of reducing costs other than wages, the competition during the depression has doubtless operated in that direction more powerfully than any new influence that can be brought to bear.

Retail food prices have risen in about the same degree as general merchandise; i. e., 19 per cent from the low point. The cost of living in August, as calculated by the National Industrial Conference Board, was 7.6 per cent higher than in April.

Causes of Uncertainty

From the slackening of trade and industry the inference is drawn that business men are assuming more of a waiting attitude than heretofore, and will continue cautious until there has been a longer test of the price increases and the outlook is clearer in other respects. The inducements to buy ahead in the primary markets and at wholesale have gradually lost some of their force, and since the markets have ceased to move only one way the uncertainties in the economic situation have impressed themselves more strongly upon the public mind. The increase in labor disputes is disturbing. The failure of the heavy industries to recover commensurately with those making consumer goods is arousing greater concern. The question of how producers can increase their capital expenditures, which are necessary to sustain the heavy industries, while there is no market in which they can obtain new capital, is still to be satisfactorily answered. The disparities between prices, and principally the fact that prices of farm products and other raw materials have stood still or declined for many weeks while retail prices have advanced rapidly, represent an unbalanced condition which is a threat against the resumption of the upward movement.

All of these questions, which are subjects of concern to the Administration and to economists in general, bear very importantly on the prospects for the Winter ahead. They show that the task of restoring purchasing power and getting trade moving again is more complex than was generally understood during the first stages of the recovery program; and that the expedient of increasing employment and wage disbursements, by arbitrarily shortening hours and increasing hourly rates of pay, by no means covers the whole of the problem. There is now a better understanding that the recovery program is dealing with a network of economic relationships of almost incomprehensible complexity, which if altered in one way is sure to be altered in other and unforeseen ways also, and that the effort to restore order among these relationships through arbitrary interference sets up new problems of disorder.

Some of the weaknesses in the economic situation now demanding attention, and requiring further efforts of the overhead authority to overcome them, are the results of earlier attempts to strengthen other weak spots. Thus the attempt to bring prices into line with debts by inflationary measures, plus the well-intentioned effort to correct abuses in new security flotations by enactment of the Securities Act, has had the effect of preventing revival of the capital market. The increase in costs and prices due to the distribution of a higher money income to factory workers has nullified the gains in farm purchasing power.

In short, the problems with which the recovery effort has to deal present themselves almost in the form of an endless chain.

Moreover, the check to industrial expansion, even though it leaves operations greatly above

the low point of the depression, has some sobering implications. It is one thing to put people to work at the expense of increasing industrial costs, but may be another to keep them at work if the market for the product is narrowed by the resulting higher prices. A reversal of the employment trend, in view of the rise in the cost of living, would be a very serious development.

The latest figures for employment and industrial payrolls are for the thirty days ended August 15, in which period, according to the Department of Labor, 750,000 additional workers were given employment by the industries, and payrolls were increased by $12,000,000 weekly. These increases are in contrast to the decline in industrial production during the same period. As long as expanding output was reducing unit costs of the product, except direct labor costs, it might be assumed that part of the increased labor cost could be absorbed, and the price advances restrained accordingly. Naturally this is not true when production is decreasing, causing all unit costs to mount along with labor costs. The steel industry has had to face this situation and has accordingly advanced prices of some products for fourth quarter delivery.

The Capital Goods Industries

We gave a statement last month showing that the greatest decline in activity during the depression (as in every depression) occurred not in goods of everyday individual consumption, but in goods used by the industries for purposes of further production; and to that statement we add this month the accompanying table showing the respective percentage changes between 1929 and 1932 in representative lists of consumers' goods and capital goods.

It will be observed that of 34 items of consumers' goods only eight declined as much as 30 per cent, whereas of the 33 capital goods items none declined less than 30 per cent, except for the increase in shipbuilding. The construction industries declined by 80 per cent or more, except for some supply items which dropped 50 to 60 per cent, and the market for heavy railway equipment disappeared almost entirely. On the consumers' goods side, on the other hand, the only three items to decline as much as 60 per cent were furniture, vacuum cleaners and automobiles, all durable articles which might properly be listed in a special classification of consumers' capital goods.

As a guide to the relative importance of these two classifications of industry the Census of Manufacturers, with construction figures added, will serve sufficiently well. A division of the industries by great groups suggests that producers' goods and consumers' capital goods together, including construction of all kinds and passenger automobiles, accounted for about one-half of the value of the country's industrial production in 1929, and consumers' goods of relatively short life for the other half. Employing the same classifi-

Movement of Consumption Goods and Capital Goods in 1932, as Compared with 1929

Consumption Goods	Per Cent Change
Sheep and lambs slaughtered	+17.3
Cheese, consumption	+15.5
Tea, U. S. imports	+ 6.0
Coffee, U. S. imports	+ 1.2
Milk, fluid, receipts, N. Y.	0.0
Gasoline, consumption	— 0.2
Cocoa, U. S. imports	— 5.4
Poultry, receipts 5 markets	— 6.1
Tobacco, smoking, etc., withdrawals	— 6.5
Flour, wheat, consumption	— 7.8
Rice, shipments to mills	— 8.0
Butter, consumption	— 8.8
Silk, raw deliveries	—10.6
Eggs, receipts 5 markets	—12.3
Cattle and calves, slaughtered	—12.8
Cigarettes, withdrawals	—13.0
Shoes, production	—13.2
Hogs, slaughtered	—14.7
Citrus fruit, carload shipments	—15.5
Fish, landings, principal ports	—19.2
Apples, carload shipments	—20.8
Potatoes, white, carload shipments	—22.5
Sugar, raw, meltings 8 ports	—23.0
Onions, carload shipments	—24.6
Newsprint paper, consumption	—25.7
Cotton, raw, consumption	—28.8
Cigars, withdrawals	—32.2
Wool, raw, consumption	—34.2
Coal, anthracite, shipments	—34.7
Candy, manufacturers' sales, $	—39.9
Tires, casings, shipments	—40.5
Household furniture, shipments	—64.0
Vacuum cleaners, shipments	—64.3
Automobiles, passenger, prod.	—75.2

Capital Goods	Per Cent Change
Ships built, merchant	+ 2.5
Oil wells, drilled	—32.8
Roofing, prepared, shipments	—42.3
Public works construction, $	—45.0
Cement, shipments	—52.6
Paint and varnish sales, $	—53.0
Sulphuric acid, production	—57.9
Lead, refined, shipments	—59.5
Lumber, Southern hardwood, shipments	—61.7
Plate glass, production	—62.2
Plumbing fixtures, china, shipments	—64.5
Radiators, heating, shipments	—64.5
Lumber, Douglas fir, shipments	—65.8
Auto trucks, production	—69.5
Pumps, power, shipments, $	—72.8
Structural steel, shipments	—73.8
Steel bars, cold, shipments	—74.4
Welding sets, orders	—75.9
Electric motors, shipments, $	—76.0
Boilers, steel, orders	—80.7
Residential building, area	—81.0
Iron ore, consumption	—83.9
Brick, sand-lime, production	—85.0
Steel rails, production	—85.2
Public utility construction, $	—85.6
Machine tools, shipments	—86.7
Commercial building, construction, $	—86.8
Steel castings, production	—87.0
Electric furnaces, orders	—87.1
Factory construction, $	—92.1
Locomotive, steam, built	—95.4
Electric cranes, shipments, $	—95.9
Freight cars, built	—99.3

cation, between 1929 and 1931 the value of capital goods output declined approximately 50 per cent, and the value of consumers' goods about one-third, and capital goods in 1931 represented about 40 per cent of the national output. In both years the capital goods industries gave employment to more workers than consumer goods, by a substantial margin.

Since the improvement set in last March many of the capital industries have recovered substantially, but in virtually no case have they regained more than a small part of the ground lost since 1929. The steel industry is a case in point. The sharp revival experienced between March and July was based principally on automobile, tin plate and miscellaneous demands, and when these declined after July the necessary business from the construction and railway industries was not forthcoming to take its place.

Taking these two sets of figures together the evidence is clear that the chief area of depression at present is in the capital goods industries. The wage and salary expenditures of these industries represent purchasing power for consumer goods. As long as they are depressed, therefore, the buying power available for consumer goods will be correspondingly curtailed. This is another demonstration that the fundamental condition of prosperity and the free flow of trade is a state of balance in the economic system, so that all the industries can exchange their products.

Profits and a Capital Market Essential

With retail prices advancing as they are the Administration recognizes that unless capital goods output is stimulated the recovery program is endangered. The conditions necessary to give this stimulation can be stated briefly. The first is that producers must operate at a profit or in expectation of a profit, since this is the inducement for them to add to or improve their facilities for production, and since without profits they will lack either the funds to spend for new facilities, or the credit standing to obtain them. The second requirement is that there shall be a market in which the industries may obtain or borrow capital. In either a free or controlled economy both of these requirements must be met.

Meanwhile the Administration is offering to finance purchases of railway equipment, and is endeavoring to speed up the public works expenditures. It is difficult to make these expenditures rapidly, and the attitude of Secretary Ickes that "it was never intended that the public works program should be a public grab bag" appears to have evoked some impatience. However, the Secretary stands his ground on this principle, and blames the major delays on "the inability of local agencies to put to work the money already allotted them."

The figures of building contracts awarded during the first half of September give evidence of these delays. They show the public works and utilities classification running below the corresponding figures of a year ago by 25 per cent, though substantially higher than in earlier months this year. The building totals as a whole are not without encouragement. Both residential and non-residential contracts for the period were larger than last year, and all classes show gains over August, the daily average, $4,606,000, being the largest in twelve months. Residential construction has now run ahead of 1932 in each month since May.

The Farm Situation and Demands for Inflation

Along with the lag of the capital goods industries, the lag of agricultural prices, to which we have already alluded, is recognized as one of the handicaps to recovery. Prices of farm products have declined since the middle of July, the latest report of the Bureau of Labor Statistics showing a drop of 11 per cent from the peak. Within the past month cotton has dropped close to 9 cents in New York and wheat to the low 80s in Chicago. Secretary Wallace made a statement of the situation on September 9, in which he said that while the farmer's cash income has been increased the higher retail costs have absorbed the increase, and left him no better off for meeting his interest, taxes, and fixed charges. "Our people are likely to get impatient within the next three months," he said, "and demand a strong dose of inflation."

It is not surprising that demands for outright currency inflation have been revived by farmers or their representatives. The farmer has experienced within recent memory the effects of a speculative demand for his products partly stimulated by inflationary measures, and all the history of inflation shows that as its effects wear off after the first experience there is always a demand for more. The argument that more currency is needed is raised again, in the face of the steady decline in the amount of currency in use throughout the period of recovery, which demonstrates that additional currency is not required and that it will not stay in circulation if it is put out beyond the needs of trade.

These renewed demands for inflation have revived the discussion of monetary policy in a disturbing manner, resulting in a further flight of capital from the dollar, and a greater depreciation of its value in the foreign exchanges. For some time the dollar has been around 35 per cent discount from gold, compared with the previous low of 32 in July. The official price at which the Treasury undertakes to sell newly-mined gold to the arts or abroad has been as high as $32.28 an ounce, compared with the statutory price of $20.67.

This increased depreciation of the dollar gives opportunity for an examination of the effects of progressive currency debasement upon prices. Moody's index of prices of fifteen sensitive commodities, of the kind which are influenced earliest and most strongly by the sentimental and trade effects of monetary changes, made its high point on July 13, at 148.9 (Dec. 31, 1931=100). Subsequently it declined to 126.7 on September 9, rallied to 136.5 in the next week, and on September 28 was 131.4 Thus, while these prices rallied temporarily during the decline of the dollar they at no time have been as high as in July, even with the assistance of N. R. A. and A.A.A. measures taken since that time. Evidently currency depreciation is an insecure basis for an advance of prices, even of commodities entering world trade, and sensitive to such influences.

With the dollar depreciated 35 per cent, and the price trend as shown, what is now to be said for the calculation that a 40 or 45 per cent reduction of its statutory gold content would raise prices to the average pre-depression level? On that level the Moody index would be about 240, and our readers may use their own judgment as to the degree of inflation that would be necessary to advance prices to that point.

Need for Confidence in the Currency

More aggressive agitation on the part of inflationary groups in favor of Government paper money issues has been met by a mounting opposition in the press generally, and from leading public men all over the country. In Administration circles, Secretary Wallace, whom we have quoted as reporting the demand for inflation, has also stated (referring to inflation, price-fixing and dumping plans) that "without production control they are only a patchwork on a structure that is badly off balance at its base." This puts the responsibility for the trouble where it belongs, on the lack of balance in the economic structure rather than on gold or the currency. President Roosevelt has announced that the Government will lend to cotton farmers 10 cents a pound on their holdings of this year's crop on condition that they accept the A.A.A. program for reducing acreage in 1934 and 1935. Coming at a time when demands for inflation were at their height, this is in the nature of an answer, and implies adherence to the principles of organized readjustment rather than to the doctrines which explain the depression in terms of money.

That the economic situation would be immeasurably benefited by some assurance or declaration of policy which would establish confidence in a reasonable stability of the currency, and in firm control over it, is a proposition from which there can scarcely be dissent. Rightly or wrongly there is distrust of the situation, and not only because of the political pressure that the advocates of inflation can exert. Even neutral observers fear that the effort to put people back to work and raise prices more rapidly than the natural pace of recovery will lead to the exercise of a stimulus, to wit, fear of the money, in order to start speculative or protective forward buying again. Evidence of growing uneasiness on the part of investors concerning the likelihood of inflation has appeared during the past month in the sharpest reaction in high grade bond prices since last April.

It is evident that there is everything to gain from the removal of this distrust and the restoration of confidence, which is essential to revive the flow of capital and the purchase of capital goods, and thus to effect the necessary increases in purchasing power. Uncertainty is the greatest obstacle to revival.

It is not in the interest of anyone that the recovery program should be pushed so rapidly as to make it impossible to maintain balanced relations, order and confidence. The principle involved is that the program will succeed to the extent that it harmonizes with and accepts the guidance of the natural economic forces which have accomplished all of the progress of the past, and acts only to supplement and facilitate their operation. There have been abundant indications for more than one year that the natural forces are operating in the direction of recovery, and given a program in step with them, and monetary security, there is every reason for confidence that the instincts of business men to do business will keep the recovery going in enduring fashion.

Money and Banking

The extreme ease of money which has been a feature of the business situation ever since last Spring has become even more pronounced during the past month. Under the influence principally of continued Federal Reserve purchases of Government securities in the open market, the volume of bank reserves has mounted steadily to higher and higher levels, and inasmuch as the loans and deposits of the member banks have failed to maintain a corresponding rate of expansion, the excess reserves of these banks have risen to a new record peak of something over $700,000,000, compared with the previous high level of around $635,000,000 last January. Money rates have continued to soften under pressure of this enormous supply of free funds, dropping to levels lower even than before. For the first time in at least the recent history of the Stock Exchange, call loans were quoted officially at less than 1 per cent, while bankers'

acceptances, at ¼ of 1 per cent for 90-day maturities, equalled the record low point of last January and February.

Evidence also of the state of the money market appeared in a reduction in the cost of financing to the United States Treasury, the September 15 offering of approximately $220,000,000 nine-months Treasury certificates bearing ¼ of 1 per cent interest, making the coupon rate the lowest on record for a nine-months maturity. Weekly offerings of Treasury bills continued to be taken on a diminishing yield basis, the average return to the investor on the block allotted September 25 being 0.10 per cent, against 0.09 per cent, the extreme low, on a block sold last December.

As indicated in the paragraph above, the source of the latest additions to the already overflowing money market has been the expanded program of Government security buying by the Reserve Banks. Since the latter stepped up their schedule of open market purchases from around $10,000,000 weekly to approximately $35,000,000 weekly in the middle of August, the total holdings of "Governments" by the central institution have recorded a net increase of $144,000,000 to a record total of $2,238,000,000. Of Federal Reserve funds put into the market by the operations of the past month, the member banks used approximately $33,000,000 to reduce rediscounts, which fell to the unusually low level of $133,000,000; the balance went principally to reserves, which, though already larger than the banks under existing circumstances can safely utilize as a basis of credit operations, have nevertheless been built up to still higher levels.

Despite this continuous pumping of new credit into the market, the volume of member bank credit in use has not displayed the increase which is the object of the monetary policy. While Federal Reserve holdings of Government securities have been increasing, and bank reserves rising, the volume of member bank loans and investments has changed but little. Unsecured loans, which include under this classification loans made for commercial purposes, did indeed increase by a moderate amount, but these increases were more than offset by decreases in loans on securities and in security investments. Deposits during the period increased by approximately $100,000,000, reflecting chiefly funds put into the market by Federal Reserve activities.

Criticism of Bankers

The failure of bank credit to respond more promptly to this high pressure expansion program has been cause for a renewal of the charge that bankers are not displaying the liberality which they should in dealing with applications for credit. This, of course, is an old charge which always crops up in times of depression when a great many business men have lost money and are in need of additional capital. Such persons cannot understand why the banks are not in a position to stake them to a new start in business.

In view of these controversies it seems desirable to recall some of the first principles of commercial banking—to wit, that loans should be of comparatively short maturity, be based on strictly commercial transactions, and be self-liquidating in character. Commercial banks, whose liabilities are largely payable at short notice, are not in a position to tie up their funds for long periods. Nor does it accord with sound banking practice for them to accept loans involving any considerable element of risk. They get enough of such loans despite their efforts to avoid them. The complaint that bankers are unwilling to make loans except on a "sure thing" is founded on ignorance of the proper function of banking. "Sure" loans are precisely the only kind of loans that banks ought to have in their portfolios. It is not in the interest of the banks, their depositors, or the community at large that the banks should "take a chance" in connection with their credit operations.

In the first place, the interest rate which a bank charges for use of its money is not high enough to compensate for the risk of becoming involved in the customer's business. The bank gets paid merely for the use of a given sum of money, the assumption being that the loan will be so secured as to render its repayment a matter of practical certainty, at least in the light of the conditions prevailing at the time the loan is made. It is not intended that the banker should share with his client in the hazards of his trade; the interest rate does not cover such hazards, which properly belong to the entrepreneur, who has the benefits of whatever profits are yielded by the enterprise.

In the second place, it is not in the interest of the bank depositor that the banker should let down the bars against questionable loans. The depositor puts his money in the bank, and expects the bank to have it ready for him when he wants to take it out. In such case, the primary duty of the banker is clear,—he has no right to venture this money, which does not belong to him, in transactions about which there is any cloud of doubt. He has no choice but to employ the utmost circumspection. Granted that the bank has a responsibility to the borrower, the obligation to the depositor is still paramount. In fact, no banking system can exist which does not seek first to protect the depositor whose funds are the foundation of the entire structure.

In the third place, it is not in the interest of the business community to have credit made too easy. If bank credit is used to supply mercantile and industrial capital there is dan-

ger that it will foster over-development and intensify destructive competition. Every business man knows that in practically all lines of business there is a large number of concerns in the hands of incompetent managers and operating on inadequate capital whose existence and methods of competition are a menace to all around them. It is for the good of all that such concerns be eliminated. Business men should supply their own capital, a requirement which would provide an automatic check on this type of over-development. The extension of bank credit for capital purposes not only tends to impair the liquidity of the banks and diminish their ability to serve in their proper sphere, but is likely to prove a boomerang to the business community itself, which is supposed to benefit most from a so-called liberal lending policy.

In short, the problem of getting credit into circulation is not as simple as it may appear on the surface. Banks are ready and eager to lend whenever a customer walks in whose credit standing is such as to entitle him to the money. Unemployed reserve affords no sense of gratification to the banker, for money is the banker's stock in trade, and idle money burns a hole in his pocket as surely as does slow merchandise for the drygoods wholesaler and retailer. Banks need increased earnings. Their dividends have been cut and their reserves written down to cover losses. They want to build up their earning power, hence they have every natural inducement to make loans whenever they can safely do so. It is useless to scold them for the failure of credit to expand when the business community is not bringing paper to them which is of a character to command their confidence.

It is perfectly true that the question as to what constitutes a good credit risk is to a certain extent a matter of individual judgment, which may vary between different persons, and often also with the same person at different times. It is natural and proper that bankers should scrutinize loan applications more carefully under present conditions than in normal times. It is doubtless true that some bankers, having in mind the events of the past year, have been overly conservative in their appraisals. By and large, however, we have no hesitancy in challenging the contention that deserving borrowers are being hampered by inability to secure credit. Where such charges have been made and investigated the propositions almost invariably have been found to be of a kind not warranting banking accommodations.

The Attack on the Gold Standard

Last month the argument for the devaluation of this country's standard of value as presented by Professors Warren and Pearson in numerous articles and addresses was selected as the text of the discussion because it presented in very brief form the substance of all the arguments and representations that have been made in support of the contention that the gold standard was responsible for the fall of prices since 1929 and that devaluation was necessary to a recovery of prices. Practically the whole case for that contention is embodied in the quotation from their joint article and in Professor Pearson's letter, which advances the theory that all payments in terms of money are in effect demands for gold and that the burden of such demands upon the gold reserves is not appreciably lessened by the use of paper money or the facilities for payments afforded by the banking system. Despite the methods which have been adopted since primitive times for economizing in the use of gold, these gentlemen contend that "cotton and wheat sell for ounces of gold" and that it is "relatively unimportant" whether the monetary gold stock is utilized in central bank reserves as now is universally the rule or is scattered in hand-to-hand circulation as in former times.

Modern Business Methods

These theories are not in accord with the business and banking practices of recent times. In fact, economies in the use of gold and silver as common media of exchange began hundreds of years ago, and even before 1914 much the greater part of the payments of all commercially-advanced countries was effected by means of credit instruments. It would be interesting to have an explanation from Professors Warren and Pearson of why this practice ever developed if there is no economy in it. That it should develop slowly at first is explained by habit, but the suspension of gold payments in nearly all countries during the war led to a greatly increased use of credit currencies.

Our treatment of this subject last month was largely devoted to a showing of the great expansion of credit facilities and means of payment which occurred in this country from 1913 to 1929 and 1932. We wish now to give a more complete exposition of the part which gold plays in all modern monetary systems and also of the part which banking facilities play in effecting the payments of trade, both domestic and international.

A Letter From Professor Kemmerer

We are in receipt of the following letter from Professor Edwin W. Kemmerer, head of the International Finance Section of the Department of Economics and Social Institutions, Princeton University. Professor Kemmerer is a specialist in money and banking of international standing, and has been consulted by more governments for advice about their

finances and currency systems than any other man, either in this country or elsewhere. Moreover, his advice has stood the test of trial, for while some of his central banks have been obliged to suspend gold payments under the extraordinary conditions which have compelled the Bank of England and the Federal Reserve system of the United States to do likewise, the possibility of such conditions had been contemplated by him and every possible provision made against them. The cause of all of the Central bank suspensions is discussed further on in this article. Professor Kemmerer's letter is as follows:

PRINCETON UNIVERSITY
Princeton, N. J.
September 15, 1933.

I have just read with much interest your able discussion of the subject, "Did Gold Cause the Depression?" contained in the National City Bank's September Letter. At a time like this, when there is so much popular misunderstanding of the elementary principles of money, credit and banking, and when such misunderstanding is likely to exercise a harmful influence upon governmental policy, an article such as you have written, in my judgment, is a real public service. Your contention that the world economic crisis and depression of the years 1929-33 were not due to a world scarcity of gold; and that in its influence on prices under the gold standard the gold held in the reserves of central banks and governments is much more efficient than gold in hand-to-hand circulation and in hoards I believe is fundamentally sound. Those who maintain that the world has been experiencing a shortage in gold in recent years usually greatly under-estimate the enormous economies which have been effected in the use of monetary gold since the beginning of the World War. The subject is one to which I have given considerable attention for many years and I can find no evidence whatever to support the conclusion, that the world is today either experiencing or facing in the near future anything that can be called an enduring shortage in the supply of monetary gold.

(Signed) E. W. KEMMERER.

One of the enclosures with this letter was a copy of a discussion by Professor Kemmerer before the annual meeting of the American Statistical Association at Cincinnati in December, 1932, of a paper upon "Relation of Gold to Prices," prepared by Professors Warren and Pearson and read at the same meeting by Professor Warren. In it Professor Kemmerer enumerates the more important economies in the use of gold, saying that those developed since 1913 have been and "will be in the future" much more important than those developed prior to that time. For lack of space we are able to give only the following extract:

(3) The continually increasing establishment and development of central banks, of which the American federal reserve system, established in 1914, is the most important. The modern central bank is a great economizer of gold.

(4) The establishment of the Bank for International Settlements.

(5) The increasing custom of international clearing of gold, and of earmarking gold, thereby avoiding the tying up of so much gold as formerly in transit.

(6) The enormous increase in the use of checks throughout the world, even in the more backward countries. The efficiency of a gold dollar held in reserve in an American federal reserve bank is something like 40 times as great as that of the same dollar in hand-to-hand circulation.

The Chief Functions of the Gold Standard

In our discussion of last month, we referred briefly to the oft-repeated representation of the modern credit structure as "a pyramid of paper money, credit and obligations of all kinds resting upon the gold reserves," as a misconception of the facts. We are now pleased to find in an address by Professor Kemmerer before the Pan-American Conference of 1931 an adequate treatment of this subject, from which we extract the following, with regret that the entire address is not available to all persons interested to understand the functions of gold in modern monetary systems:

A central bank's reserve should not be looked upon principally as a "backing" for the bank's note circulation and deposit liabilities, nor as fundamentally a guarantee of the bank's ability to meet these obligations. All the assets of a central bank perform this function. A central bank's reserve is not concerned so much with the question of the ultimate solvency of the bank, as with the question of the machinery that will maintain the gold value of the bank's notes and deposits through adjusting the supply of the circulating media—bank notes and deposits payable by check—to the changing demands of trade, increasing their circulation when trade demands increase and decreasing it when the demands of trade fall off. In this way, currency at one time is prevented from depreciating because of redundancy and at another time from appreciating because of scarcity. A central bank's reserve is primarily, therefore, a "regulator fund," and it functions successfully only when it is actually used to decrease or increase the country's circulating media. A dead gold reserve, namely, one which is not actively used for redemption purposes, is practically useless and performs no important function in the maintenance of the gold standard.

There ought to be an end to the mistaken idea that because gold is the standard of value it bears the burden of all demands for currency. Any medium of exchange has a utility value corresponding to its nominal value, so long as the supply is closely adjusted to the needs of trade.

Professor Kemmerer referred also to the other of the two most important functions of gold. Briefly stated, the gold reserves not only regulate the domestic credit currencies but serve as what may be called expansion joints between the currencies of the world, connecting them and holding them in fixed relations while permitting the domestic currencies to expand and contract independently to suit domestic conditions, all the time affording a common system of prices for the financial relations of all the countries in the gold standard system. Without some effective means of maintaining this fixity of monetary relations chaos would ensue in international business relations, as any one will agree who has had experience with them since Great Britain and an important group of nations left the gold basis in 1931, and especially since the United States took its departure in March last. For simplicity and effectiveness in this service nothing yet developed compares with the gold standard.

The Service of Currency in Trade

Professor F. W. Taussig of Harvard University in his "Principles of Economics," which is a common textbook in schools, (p. 115) gives a brief but graphic statement of the common service of money in trade. After describing the division of labor in industry and explaining that all of the different industries and their subdivisions are cooperating (although to a great extent unconsciously) in supplying the varied wants of the population by a complex system of exchanging services, he says:

> It suffices here to note how completely division of labor and exchange work out their results through the use of money. Every producer gets his return in amounts of money. The exceptions in any of the countries of advanced civilization are so few and so rapidly disappearing that they serve only to make clear how virtually universal is the rule. Exchange takes place by first selling goods for money and then buying with the money such other goods and services as are wanted. The fundamental fact of exchange is thus obscured by the very mechanism that so perfectly facilitates it. Just as the cooperation and combination which are essential features of the division of labor are carried on without a consciousness of any combined action, so the process of exchange goes on without the consciousness that it is the aim and end of all buying and selling.

This quotation shows that the key to an understanding of the business organization as a whole is recognition of the fact that all business consists of an exchange of services. It means that the goods and services moving in trade really pay for each other and that money as currency plays only a mechanical part. It is a convenience, a memorandum ticket, a certificate of service-rendered, or, if you like better, an order on the markets for goods to a certain value, but always a means of converting something you own into something else that you want. As Professor Taussig says, "the fundamental fact of exchange is obscured by the very mechanism that so perfectly facilitates it." Dr. Richard T. Ely, in his letter published in these columns last month said:

> Goods and services are exchanged for goods and services. In the proper functioning of economic society, money and credit are simply the instruments—the media—whereby goods and services are exchanged.

The service of money, therefore, is analogous to that of means of transportation or the service of railroad cars. This is a fundamentally different idea from that which conceives money to be the motive power behind all business and that more and more money will always make more and more business. Enough cars are needed to handle the traffic, but you cannot create traffic by multiplying the number of cars. There are more ways of using money than of using railroad cars, but when the facilities for making payments are ample to handle a volume of business up to the full capacity of the industries, with prices at a stable level, additional supplies of money produce a state of inflation which disturbs, confuses and works mischief in all the relations of regular business. The ways of using such additional supplies are all in the field of speculation, which will absorb any quantity and cry for more, as witness the experience of this country from 1918 to 1929.

The Use of Bank Credit as Means of Payment

The essential service to be performed by currency in domestic trade is that of accomplishing the exchanges, and nowadays this is effected mainly by means of bank credit, either in the form of circulating notes or bank deposits circulating by means of individual checks. One of the chief explanations of popular misunderstanding of the money question is a lack of understanding of the increased service of checks, resulting from the clearing system. The figures given in these columns last month show that in the active business years 1925-1929 bank deposits in this country averaged ten times the money in circulation, and that the turnover of all deposits of the reporting member banks of the Reserve system rose to a rate of 45 times a year. In other words, the sum total of deposits was being checked out at the rate of 45 times per year.

Professor Taussig, discussing the use of bank deposits as means of payment, (p. 34) says:

> All use of money could be done away with, if there were but a single bank, if all deposits were kept at it alone, and if all payments were made by checks on it. The payee of a check ordinarily "deposits" it. Thereupon this single bank would deduct so much from the amount credited to him who drew the check, and add so much to the amount credited to the payee. No money would pass, and the payments would be effected simply by substituting one person for another as the bank's creditor (i.e. depositor).

He then goes on to show that the service which conceivably might be rendered by a single bank actually is obtained through the clearing system. There were at the end of 1932 430* "clearing houses" in the United States to which the banks of that many cities or communities belonged. Here representatives of the banks meet daily and exchange the checks on each other which they have received during the day, and which usually cancel out within 5 to 10 per cent of the total. If the drawer and receiver of a check both have accounts at the bank on which it is drawn there is no need for it to go through the clearing house, for the bank accomplishes the transfer of credit by entries in its own books. Thus 90 per cent or more of the checks issued never are cashed in any kind of money, but are cancelled in the performance of their service. This does not simply happen so, but results from the basic fact that all business consists of an exchange of services.

Professor John Maynard Keynes, of Cambridge University, one of the most prominent

*This figure obtained from the Clearing House Section of the American Bankers Association.

economists of England, and especially distinguished as the author of "The Economic Consequences of the Peace," a trenchant criticism of the Versailles Treaty, in his two-volume work (1930) entitled "A Treatise on Money" (Vol. I, page 26), says:

If we suppose a closed banking system, which has no relations with the outside world, in a country where all payments are made by cheque and no cash is used, and if we assume further that the banks do not find it necessary in such circumstances to hold any cash reserves but settle inter-bank indebtedness by the transfer of other assets, it is evident that there is no limit to the amount of bank-money which the banks can safely create **provided that they move forward in step.**

It will be seen that he uses the term "bank-money" to describe the bank deposits that are being used in the settlement of this vast volume of business. He means that they are performing the function of money, and says that subject to certain conditions, which do not materially curtail the volume of such operations, "there is no limit to the amount of bank-money which the banks may safely create." Here again is the doctrine laid down by practically all economists, that "goods and services exchange for goods and services," and that there is no limit upon such exchanges so long as they are in a normal state of balance.

It should be added that the "clearings" do not stop at the clearing houses, for the balances at the clearing houses are no longer settled in money as formerly, but by checks on the Federal Reserve Bank of the district, and the claims of the Reserve banks on each other are forwarded to the Federal Reserve Board in Washington, D. C., where a final clearing occurs through what is known as the Gold Settlement Fund. Each Reserve bank keeps in the Treasury of the United States a sum of gold coin sufficient to settle the balances which may accrue against it in its relations with the others. This is a clearing of all the claims that the twelve Federal Reserve districts have on each other and resulting from the total of domestic trade. These balances are nominally settled in gold, but in fact they are settled by book credits and debits. This is the only place where gold figures even nominally in our domestic payments, hence the only place where domestic business may be said to occasion a demand for gold. Even here, as suggested by Professor Keynes in the above extract, the settlements might be made by the "transfer of other assets,"—for example, government bonds—if there were any occasion to do so.

As of the end of August, 1933, the Gold Settlement Fund held about $532,000,000 of the total stock of $4,009,000,000 held by the Federal Reserve banks and the United States Treasury, or 13.3 per cent. With all countries on the gold basis, the situation in each would be similar to this, and there would be practically no business demand on the gold reserves but for the settlement of international balances. And yet all of the business of the world would be done by the gold standard and prices in every country would have definite relations to prices in all other countries. Such is the service to civilization and human intercourse rendered by the gold standard.

In view of the incontestable evidence as to the business practices of the present day, what is to be said of the insistent claim that "cotton and wheat sell for ounces of gold" and that every payment in terms of money constitutes a demand on the gold reserves?

Possible Expansion of Credit and Means of Payment

Before closing this discussion of the alleged inadequacy of gold supplies, the fact should be mentioned that indefinite expansion of credit and currency is possible without going off the gold basis. We have seen that the principal functions of gold reserves in modern monetary systems are those of regulating the volume of credit currencies, maintaining fixed relations between the currencies of different countries and effecting the international payments. The supply of a credit currency is provided by each banking system in response to current requirements of business, and its value is maintained by retiring any redundant supply—as the value of commodities may be stabilized by removing the surplus,—and international payments are accomplished by the Central banks through a system of clearings, similar to the internal settlements described above. Under normal conditions all of this machinery works so regularly that gold movements are of small volume.

The "reserves" need to be related to the probable or possible balances which may accrue in the settlements, rather than to the aggregate volume of trade. In the history of the United States down to the Great War there was only one year (1898) in which net gold imports or exports exceeded $100,000,000. It is safe to say that a very long time will elapse before any increase in the present gold reserves of this country (approximately $4,000,000,000) will be required for handling our adverse international balances, or any domestic requirements. In the normal course of business the Central banks themselves, through their relations to the banking systems, have sufficient power over international business to control the balances. All that is required is to keep business on an even keel. Of course, this does not contemplate world wars, but it would be useless to plan for monetary stability, price stability, or any stability, in the event of a world war.

All of the failures of Central banks to maintain gold payments since 1914 have been chargeable to the enormous disturbance of

trade and all business caused by the war. The balances resulting from the disruption of trade relations, the great and uneven fall of prices, the conditions of panic, and the shifts of capital, were so abnormal that they could not be met from the gold reserves. But a world war is no greater menace to the gold standard and the modern banking system than it is to all of the other institutions of an advanced civilization. The effects of the war upon monetary and banking systems only reflect its effects upon business.

In the article upon this subject last month we referred to the action of the British Parliament in authorizing the Bank of England to increase its note issues based upon securities by a sum equivalent to about $1,200,000,000. This action was based upon the belief that the total of the "fiduciary" issue would still be so small in relation to total amount of bank notes required in circulation that this increase could safely be made. Our own national bank notes are secured by government bonds, with but an insignificant provision for redemption in "lawful money," a term which includes not only gold but silver dollars and the "greenbacks," both forms of government credit—a policy based upon the same theory as the British fiduciary issue. The Canadian bank notes are redeemable in a limited issue of Dominion currency, another example.

These cases are sufficient to establish the validity of the statement, made above, that indefinite expansion of credit and currency may be had without going off the gold basis. The theory is applicable to any banking and currency system, and is sound so long as the increase of the "fiduciary" issue does not exceed the growth of domestic production and trade, thereby producing inflation. All of the "managed currency" arguments are based upon the principle that a credit currency can be stabilized in value by proper regulation of the volume. The very idea of "management" as applied to currencies has been developed in Central banking experience and is practical only through Central banking management; moreover, there is reason to believe that its best possibilities will be realized through Central bank cooperation on the gold basis. Independent management of currencies without a common basis is the very peril to be avoided, and there is more need of management for bank credit and for the public policies which abnormally affect international balances than for regulation of the gold standard itself.

We submit that the alleged "inadequacy of the gold supply" is a figment of the imagination and should not be entertained by anybody who understands how modern business is done.

The Economic Equilibrium

The lesson to be drawn from all of the foregoing is the vital importance of exchange relations between the different population groups which comprise the economic system. The bank clearings reflect the commodity clearings in the markets and show the very process by which goods and services pay for goods and services, as Dr. Ely has said they do. When trade is in a normal state of balance the flow of goods into consumption is rapid, production is high but the markets are cleared, prices are sustained, employment is full, wages are maintained or rising, and bank clearings rise to new high levels. This is prosperity; the various agencies of production and distribution are working harmoniously together.

When for any cause goods and services are offered in unbalanced relations—either in quantities or prices—the markets will not be cleared, the flow of goods into consumption will be checked, surpluses will pile up and prices will fall, unemployment and pressure upon wages will develop. In short, all of the symptoms of disorder with which we have been familiar over the last three years will quickly appear, and payments through banks, the principal method of making payments, will fall off as shown by the following figures:

Total Debits, Reporting Member Banks of Federal Reserve System, Years Stated

Year	(000,000s omitted)	
1929		$935,027
	Annual Average, 1925-29	718,663
1930		661,957
1931		481,357
1932		322,367
1932,	November (low month of Depression)	20,750
1932,	First six months	173,147
1933,	" " "	146,787
1932,	Month of July	25,239
1933,	" " "	31,232
1932,	" " August	25,215
1933,	" " "	25.452

The figures for the total payments in 1932 are but slightly more than one-third those for 1929, but this does not indicate a similar decline in the volume of regular trade, for speculative transactions in stocks and other kinds of property accounted for an important part of it. However, the statistics of international trade for the world show a falling off from 1929 to 1932 of approximately one-half, and this was purely a movement of commodities. The fall of prices also was an important factor in the decline of the volume of check payments, but this was directly due to the unbalanced state of trade.

Mention is made above of the fact that the Central banks which have suspended gold payments since 1929 were compelled to do so by the heavy balances accruing against them in the foreign exchanges. Most of these suspensions occurred in countries where exports were principally of primary products, and the cause was a disproportionate decline in the prices of such products in comparison with those of the manufactured goods they were

accustomed to import, and in the total value of their exports in comparison with the total value of imports, plus the sums of interest and other fixed payments they were owing abroad. These countries proceeded drastically to reduce their imports, and when their gold reserves were exhausted, to suspend payments.

A similar situation has existed within the United States between debtor and creditor sections and between the population groups engaged, on the one hand, in the production of the agricultural staples and other primary products, and, on the other hand, in manufacturing and transportation. Normal exchange relations between them have been disrupted, the cash reserves of the former have been drained away, with disaster to their banking institutions, and their loss of income has caused a drastic reduction of their purchases, with resulting unemployment in the urban industries.

The loss of purchasing power was by no means confined to the producers of natural products. The discussion under "General Business Conditions" shows the falling off of business among the industries producing capital goods and other goods not included among necessaries.

The Plight of Agriculture

We have not the space here to go far into the details of this disruption in exchange relations, but they have been set forth repeatedly in this publication. The details of what the war did to one important industry are set forth in the following article entitled "Cuba and Sugar." The plight of the wheat growers also dates from the war, which overstimulated production in new areas, leading to accumulation of stocks, measures by importing countries to protect home producers, and general confusion and distress.

Upon the general state of agriculture in this country we quote from a recent address by the Secretary of Agriculture, as follows:

> Here in the Department of Agriculture we recently compiled a chart that had only two lines on it, one bending up, and the other bending down. The upline showed the average total production of important American crops during the years of the postwar agricultural depression. The down-line traced, month by month and year by year, the average price paid to farmers for the same crops during the same period. If you fold this chart down the middle, horizontally, it is startling to see how precisely the mounting production line is simply the falling price line, in reverse. That is the central fact of the farm situation and you can't get away from it.

Thus there is ample testimony that the disturbance of exchange relations has been primarily due to derangements in the physical exchanges, brought about by the war. The falling off of bank "clearings" reflects a blockade of the products of industry in the markets, and there is no remedy for this blockade except by the restoration of order in production and prices. Monetary systems, prices, contractural relations, are all subject to disorder in the market exchanges.

The Farm Relief Program

The policy of farm relief adopted by Secretary Wallace, with the support of the President, has been prompted by these unbalanced conditions. He has avowed the purpose to be a prompt restoration of the pre-war equilibrium between agriculture and the other domestic industries. It is frankly an extraordinary policy—the Secretary says so—the slaughter of pigs, the plowing under of cotton almost at maturity, and the compensated reduction of wheat acreage. Objections may be raised on the score of all the collateral effects and long time results, but the policy has been adopted and is well advanced in execution. It is possible to say that if it clears away the abnormal stocks that have been depressing the markets, and actually restores agriculture to its normal position in the economic situation, it will be worth the direct costs as they are calculated.

However, the Agricultural Adjustment Administration is not the only government authority working upon the economic situation. The National Recovery Administration is carrying on independent operations guided by a seemingly different and more or less conflicting theory of the depression. It seems to have adopted the theory that machine production has so reduced the demand for manual labor that the only way the evil of unemployment can be overcome is by restricting the hours of machine operations and spreading the amount of employment among all applicants. Hence the new codes, providing for the restriction of operations to from 30 to 40 hours per week.

Labor troubles seem to have increased as a result of this policy, the explanation being set forth in the following newspaper statement regarding a strike of 3,000 employes in the Ford works at Chester, Pennsylvania:

> Until this week they had been working forty hours a week with a 50 cent minimum hourly wage. They were notified on Friday of a 32-hour schedule with the minimum hourly wage unchanged, cutting the weekly minimum to $16.

The effect of such wage changes upon production costs, if general throughout industry, will soon be demonstrated, and the immediate question is what will be the effect upon the efforts of the Department of Agriculture to restore the pre-war equilibrium? If all other prices are raised by the Industrial Recovery Administration, will it be necessary for the Agricultural Adjustment Administration to extend the slaughter of pigs and the restriction of cotton, wheat and other farm products? And will the resulting increase of living costs prompt a further reduction of working time and increase of wage-rates in the other industries, with the inevitable effects upon prices?

And, finally, may not the best solution of the problem be found by seeking an adjusted equilibrium, based upon normal production all around, with an abundance of all the comforts of life instead of upon all-around scarcity?

Inflation No Remedy

It should be evident that inflation of the currency or devaluation of the dollar is no remedy for such a situation, but would only intensify the confusion by creating uncertainty as to all values. The proposal is based upon the fallacy that purchasing power originates in money (even printing press money) instead of existing in the products and services being exchanged. It illustrates Professor Taussig's aphorism that "the fundamental fact of exchange is thus obscured by the very mechanism that so perfectly facilitates it." If values really originated in money, a restriction of working hours in all lines of industry, including agriculture, could be made good by raising the money compensation all round, but in truth no amount of money can make good an actual shortage of the necessaries of life.

The idea that more money is needed because at present so many people are not getting any of it, is fallacious because the normal distribution of money is by the activity of the industries. Except as given in charity, there is no rational way of distributing money but by payments for products or services. The widespread distribution of money through wages obviously depends upon activity in the industries, and a normal distribution to farmers depends on a rise in prices of farm products.

There is no reason for thinking that the pumping of fiat money into circulation would correct the maladjustment existing between agriculture and the other industries. That is not likely to be done in any other way than by intelligent and cooperative readjustments, in the common interest. Secretary Wallace has expressly declared his opinion that inflation will not do it. "We must," he has said "either restore world trade or permanently take out of use 40,000,000 surplus acres which were planted during the war-time boom." If this is good sense—and we believe it to be —then the theory that the situation can be remedied by printing money is not.

The plausibility of the appeal for inflation or devaluation rests entirely upon the assumption that the present price level is adjusted to the present money standard and is permanent unless the standard is reduced. There is no basis for this assumption. The present price level is due in part to the psychology developed in the last four years, as the price level of 1929 was due in part to the psychology of the five preceding years, but in both cases fundamental causes have been behind the price movement. In the rising movement from 1915 to 1920 the cause was the enormous demand for man-power and products of every kind which had its source in the war, which was sustained for a time after the war by backed-up demands of many kinds, while in the falling movement the cause has been the derangements in production and trade resulting from the change from war-time to peace-time conditions. There is no lack of money or means of payment in this country, but there is a fundamental obstacle to recovery in the confusion which exists in the exchanges. Products and services are not selling in accustomed relations to each other, and so long as that is the case consumption and employment cannot rise to normal proportions.

There is a strange inconsistency in the actions of persons who while denouncing the gold standard for an alleged instability obviously chargeable to causes outside of itself, advocate a monetary policy which the experience of all time has shown to produce the acme of instability. We repeat that there exist now in this country all of the agencies of credit and means of payment necessary, other requisites being provided, to produce the price level of 1929, and this being true every act that may have an inflationary influence is an element of danger to future stability.

It is not to be forgotten that the inflation of credit and the mania of speculation thus engendered has been the principal cause of all our troubles.

Cuba and Sugar

The newspapers have carried full reports of the upheaval in Cuba and attendant circumstances, and there is no need for us to comment upon the political situation which has arisen, beyond saying that at no time since the independence of Cuba was established has there been in this country any sentiment worth mentioning in favor of the annexation of the country to the United States.

The history of the sovereignty of Spain in Cuba is one of many vicissitudes. Not to express an outside judgment, the colonial administration was very unsatisfactory to the Cubans, and in 1868 a rebellion broke out which lasted ten years, and constantly threatened to involve the United States. The war was practically a stalemate, and peace was finally established by the promise of certain reforms. Another rebellion broke out in 1895, and proceeded inconclusively, but was attended by great suffering and loss of life to the population until the United States intervened in 1898. The immediate impulse to this action was given by the blowing up of the United States battleship "Maine," in the harbor of Havana, by unknown parties, with the loss of 260 lives. Our Government based its action upon the broad ground

that from the standpoint of the nearest neighbor, and with the consideration for human misery that is always due, the situation in Cuba was both hopeless and intolerable. It explicitly disclaimed any purpose to control the Island, except for its pacification, and the treaty of peace with Spain by which the latter relinquished its authority, fully recognized that the existing occupation of the Island by the United States was temporary and preliminary to the establishment of Cuban independence.

In the treaty between the United States and Cuba by which the relations between the two countries were defined, which was ratified by a constitutional convention, the independence of Cuba was acknowledged by the United States, but Cuba complied with the wishes of the United States by making certain agreements, which in substance were, not to make any treaty or compact with a foreign government that would impair its own sovereignty over any part of the Island, not to contract any public debt the interest upon which, with sinking fund provisions, could not be regularly met from the revenues, that it would sell or lease lands for certain United States coaling or naval stations, continue certain sanitation works necessary to protect the ports of the United States from the importation of contagious diseases, to defer the disposition of the Isle of Pines until a later time, etc., and, most important of all, the following:

> The Government of Cuba consents that the United States may exercise the right to intervene for the preservation of Cuban independence, the maintenance of a government adequate for the protection of life, property and individual liberty, and for discharging the obligation with respect to Cuba.

There are persons so prejudiced that they interpret any utterance in favor of the maintenance of public order or the protection of property as favoritism to "Business" or the "Money Power," oblivious to the fact that the mass of the people are dependent upon the activities of business for a livelihood. Whatever differences of opinion there may be now as to the wisdom of the above provision, the authors undoubtedly intended it to be helpful to Cuba. They were apprehensive that among a people inexperienced in self-government a state of disorder might arise, possibly involving social conditions as serious as those which had prompted the United States to intervene. The intention was to give assurance to the world that order would be maintained in the Island, with protection to life and property, and to discourage attempts by discontented elements to overthrow a lawful government by force.

The Government of the United States under all administrations has sought to promote order and good government in Cuba by friendly counsel and mediation. One intervention under the treaty occurred in 1906 and lasted until 1909, but the Government was manned mainly by Cubans during this period. By its original self-denying declaration upon entering the war, by treaty with Cuba after peace was established, by its withdrawal after the intervention, by the settlement of the controversy over the Isle of Pines in favor of Cuba, and by its consistent policy throughout to the present day, the Government of this country has given sufficient proof that it has no designs upon Cuba. The natural desire of the people of Cuba to govern themselves has been, is and will be respected by the people and the public authorities of this country.

Economic Relations

Notwithstanding the unimpeachable record of the United States as recited above, the people of the United States should recognize that they have a large responsibility for the state of turmoil, disorder and human suffering which has existed in Cuba in recent years and for the unhappy conditions existing there now. For those troubles have been and remain primarily economic, and Cuba is economically dependent upon the United States.

The natural products of the United States and Cuba are almost wholly complementary, not competitive. The chief product of Cuba is sugar and in the five years 1924-28 it constituted 84 per cent of the value of all the Island's exports.

Sugar is found in many plants, but the commercial product is almost wholly from two, the sugar cane and the sugar beet. The former is a natural product of the tropics, and for this reason utilizes the sun's rays in the making of sugar more effectively than does the sugar beet, which is a developed product of the temperate zone. Commercial production from beets dates from the time of Napoleon Bonaparte. Until then Europe had obtained its sugar from the tropics, chiefly the West Indies, but when in Napoleon's wars with England the latter overcame the French navy, the French Emperor founded the beet sugar industry by a system of subsidies, to provide a domestic supply. The same motive, i. e., to have an assured supply in the event of war, has prompted nearly all of the European countries to foster the beet sugar industry.

A Natural Trade

If Providence had been planning for the cheapest possible supply of sugar for the great population which one day would occupy the United States, it could not, within the range of human knowledge, have done better than by placing the Island of Cuba precisely where it is with the soil and climate that it possesses. On the other hand, the chief agricultural products of the United States never have been grown in Cuba in quantities sufficient for the

home consumption, and the country is lacking in both the capital and trained labor to supply its own manufactures. Thus there is the basis for a mutually advantageous exchange of products, and it developed from an early day. For a long time such import tariffs as were imposed by the two countries were designed to raise revenues for the governments rather than to restrict trade. However, our sugar duty gave a stimulus to sugar production in this country, first from cane in Louisiana, lately from cane in Florida, years ago from beets in California and the plains region of the West, and more recently as far east as Ohio.

As the home production increased, the agitation for more protection increased, until the rate of duty became 1.68½ cents per pound under the Dingley act of 1897, but this was reduced under the reciprocity act of 1903 to 1.348 cents. This act was carried through Congress by the earnest support, first of President McKinley, and then President Theodore Roosevelt and his Secretary of State, Elihu Root, each of whom urged that not only was it a sound national policy to maintain intimate relations with Cuba both politically and economically, but that we were virtually pledged to that policy already by the terms of the treaty which this country had practically dictated. The United States had obtained a distinctly preferred position in Cuba over any other country, including the right to maintain a naval station at Guantanamo, a strategic position for the defense of the Panama Canal and practically making the south shore of Cuba this country's first line of defense in the event of our having a war with any other country.

The reciprocity treaty went into effect in December, 1903. It gave Cuban sugar a concession of 20 per cent from the duty levied upon all other foreign sugar coming into the United States, in exchange for satisfactory concessions made by Cuba on importations from this country. On the strength of this, large sums of Cuban, American and other foreign capital were invested in Cuba in various enterprises, but especially in the rehabilitation and development of the sugar industry, which seemed to have been placed on a sure basis. It may be fairly said that the treaty was intended to establish a permanent basis for intimate business and political relations.

The Effects of the War Upon Sugar

The price of sugar was controlled during the war, and when the control was taken off the markets for a time were in great confusion. The war had devastated the beet sugar regions of several European countries, and European production fell from about 8,000,000 tons in the crop year 1913-14 to 2,594,000 in 1919-20.

The obvious deficit in supplies started competitive buying in all markets. Not only did dealers scramble for supplies, but large consumers and even families sought to accumulate stocks, with the result that in the Spring of 1920 Cuban raws sold in New York as high as 23.57 cents per lb. This, however, was without reckoning with the consumer and it soon developed that there was plenty of sugar at the price. Seventeen countries shipped sugar to the United States in that year, with resulting disaster to the sugar trade. Indeed, sugar became a drug on the market, the raw commodity falling below 2 cents in New York. Later the price recovered moderately, on account of the deficit in European production, but the beet sugar mills of Europe were rebuilt rapidly with larger capacity than before, and from that time on the sugar industry all over the world was sinking into deep depression.

The countries that were producing sugar for a part of their supply were induced by the low prices to protect their domestic producers by increasing import duties, and this production was liberal enough to stimulate further expansion, with the result that total world production increased despite the low prices. From 18,460,000 tons in 1913-14, it rose to about 24,000,000 tons in 1924-25 and to 28,480,000 tons in 1930-31, and the exporting countries like Cuba and Java found their former markets being closed against them.

The Fate of Cuba

The sugar industry in Cuba has been developed with special reference to the United States market, which was practically assured to it by the reciprocity treaty, as against all other foreign sugars. But with the increase of our import duties in 1920, 1921 and 1929, production in the United States, Porto Rico, Hawaii and the Philippines increased rapidly. At the date of the reciprocity treaty the production of beet sugar in the United States was less than 200,000 tons, and of all duty-free sugar, including the cane product of Louisiana, Porto Rico, the Hawaiian Islands and the Philippine Islands, less than 1,000,000 tons. By the end of the world war the aggregate had increased to 2,000,000 tons; the 1925-26 crop was 2,600,000 tons and that of 1929-30 3,459,000 tons. In the latter year, the Hawley-Smoot revision of the tariff raised the general sugar duty to 2.5 cents per pound, which made the reciprocity rate 2 cents. Under its influence the production of the duty-free sugars has increased each year until for the current year it is estimated at about 4,250,000 tons.

It should be understood that so long as any part of the sugar supply of the United States must be imported, the market price for all the domestic production is fixed by the price ruling for the imported supplies. In other words, the domestic and insular sugars sell just low

enough to crowd out that quantity of Cuban sugar. The Cuban production had reached about 2,500,000 tons before the war and thereafter increased steadily to about 5,000,000 tons in 1924-25 and repeated this in 1928-29, but since then under drastic governmental control the crop has been steadily reduced to about 2,000,000 tons in the present year. This has meant ruin and distress to the people of Cuba. The price of Cuban raws in New York harbor, pre-duty, has been below 2 cents in every year since 1929 and touched the low point .57 cents, in 1932. It is now about 1.60 cents. Almost continually throughout the last three years the duty upon Cuban raws has been more than 100 per cent upon the import value, much of the time above 200 per cent and at the low price-level about 250 per cent.

Almost all of the companies producing sugar in Cuba are bankrupt or in the hands of receivers, and of course the individual producers have fared no better. Certainly this is true of all who were financed to any extent by debt. Costs have been cut with unsparing hands, wages to figures that would be impossible anywhere but in a country where the climate makes the requirements for clothing and shelter comparatively slight and food can be had at only a slight outlay of labor. The purchasing power of the Cuban population has been almost destroyed.

The Last Duty Increase

When the proposal for the last duty increase was pending at Washington, the situation was reviewed at length in these columns (June, 1929) and a portion of the comment is reproduced herewith, because it describes the effects of our sugar policy upon Cuba as well as anything that could be written now.

Pan-Americanism and Cuba

For many years our statesmen of all parties have professed the doctrine of Pan-Americanism, which is supposed to mean that a fundamental basis exists for close and harmonious relations between the countries of the Americas, and that such relations should be cultivated. * * * The official headquarters of the Pan-American Union are located in Washington, D. C., and it would seem that the purpose which prompted the formation of that organization and the gift of the building which it occupies should find some degree of expression in our national legislation affecting trade. * * * We have more intimate relations with Cuba than with any other member of the Pan-American Union. * * * In view of this natural community of interests, as well as the political ties existing, it would seem that if Pan-Americanism means anything in the trade policies of this country it should appear in our trade relations with Cuba. * * *

When the full measure is taken of what the ruin of the sugar industry would mean to the 3,500,000 inhabitants of Cuba, no parallel for the disaster can be found outside of the annals of war, and the injury done in this case would be far more lasting than the injuries of war. Devastated Belgium and France have been rebuilt and are more prosperous than before, but there would be no rebuilding of Cuba until a market was found for her products. The prosperity of Cuba depends upon her ability to utilize her soil and climate for the purpose to which they are supremely suited and to trade with a population which will take such products in exchange for their own. In all history there has been no such destruction of property values or displacement of an industrial population by legislative decree as would result from forcing the people of Cuba to abandon sugar production, or even to cut it one-half. Alternative employment for the population cannot be named. The people are unskilled and without experience in anything else, and the United States wants nothing else from Cuba any more than it wants sugar. Exclusion of its products from this country would mean the depression of Cuba to a distinctly lower level of social life.

It cannot be too forcibly stated that while the beet sugar industry is fighting for expansion—to capture the full United States market—Cuba is fighting for life, to hold the place she has long held in the only available market for her product, and for the only means of a decent livelihood for her people.

The Merits of the Case

Opposition to this increase was not based upon sentiment for Cuba alone. Although there are beet sugar factories in Wisconsin, three economists of the University of Wisconsin (B. H. Hibbard, John R. Commons and Selig Perlman) submitted a brief on the subject in which they estimated that the increase would cost the consumers of the United States $150,000,000 per year, against possible benefits to the beet-growers of $43,000,000 per year, and that the cost to the farming population as consumers would be $64,000,000 per year. The argument did not prevail, because the principle of protection was said to be involved. But is the principle of reasonable protection involved in such a case? It is one thing to foster a home industry which labors under no natural disadvantage, but a different thing to tax the public for the support of an uneconomic employment of capital and labor. There must be a line between the reasonable and the unreasonable if there is to be any foreign trade.

The argument for the further development of the beet sugar industry has been that it would give the farmer another crop, and thus reduce the acreage of his natural crops, but the Wisconsin University brief answered this by showing that the number of farmers growing sugar beets is very small in comparison with the total number of farmers, and always will be under any possible development of the industry, and that the higher cost of sugar to farm families alone, not to speak of other consumers, would exceed any possible gains to the beet growers. Two cents per pound upon the 5,800,000 long tons consumed in this country annually would amount to about $260,000,000, an extra cost to the consumers, which would not be profit to the American producers, but mainly chargeable to the fact that climatic conditions are less favorable to the production of sugar in the United States than in Cuba.

The Department of Agriculture, in view of the emergency situation in agriculture, is urging the retirement of marginal lands from cultivation and the concentration of labor upon the most productive lands. The logic of this would include the elimination of crops which yield the smallest money return per unit of

labor applied, and undoubtedly this would include sugar beets, if that part of the return from beets which is due to the tariff were eliminated from the calculation.

It is said that wages and the standard of living are lower in Cuba than in the United States, and that such competition should be prevented, but there will be no competition between Cuba and the United States if we do not force it by attempting to do the work which Cuba is best qualified to do. Her standard of living and our own also will be improved by natural trade. There is no more reason why the United States should produce the sugar for its own consumption than there is why every family in this country should grow its own vegetables, make its own clothes or do its own laundry work.

The sugar industry of the United States never has supported, nor ever can support, as many consumers of this country's farm products as a prosperous trade with Cuba will support. In the ten years from 1916 to 1925 inclusive the exports of the United States to Cuba averaged about $225,000,000 per year, fluctuating with the price of sugar in a manner which clearly shows this to be the source of Cuba's purchasing power. In 1932 these exports had fallen to $28,800,000 and no class of producers in the United States escaped the effects of that fall.

Insofar as higher duties have been intended to increase the revenue to the Treasury, the results have been disappointing. Customs receipts from the sugar tariff have not been permanently increased. Reflecting the tariff advances of 1921 and 1922, together with a sharp increase in imports in 1922, the total duties collected from sugar rose from $71,300,000 in the former year to $147,900,000 in the latter. By 1932, however, the total was down again to $76,000,000. After 1926 the decline was interrupted in only one year, and was due directly to the influence of the tariff in shifting the principal source of supply from a duty-paying source (Cuba) to a duty-free source (insular territories). Moreover, if the domestic industry, including our insular territories, develops its sugar production to completely supply the domestic consumption there will be no revenue from sugar.

Pending Negotiations

The authorities at Washington have been endeavoring to arrange through mutual agreements a quota system, by which the sugar demands of this country would be apportioned to the several sources, all of the sugars included being duty-free, except the Cuban product. The schedule as submitted for adoption by the domestic and insular producers gives Cuba 1,786,000 long tons per year, which except for last year is less than its actual share in imports in any year since 1912. On the other hand the domestic and insular producers have assigned to themselves 4,486,000 long tons, an amount in excess of any year's production heretofore. The beet sugar producers have peremptorily refused to consent to any future limitation of their production. This means that they maintain the objective of eventually supplying the entire domestic demand.

The President of the National Beet-Growers Association, commenting upon the quota agreement, is quoted as follows:

> **The program agreed upon today is one which recognizes the principles for which we fought at the public hearings on the sugar stabilization agreement. We contended that the American market belongs first of all to the American farmer. We have in no sense modified our position.**

Apropos of this, it seems pertinent to quote the following from the author of the Declaration of Independence:

> **Could every country be employed in producing that which nature has fitted it to produce and each be free to exchange with others natural surpluses for natural wants, the greatest possible would then be produced of those things which contribute to human life and human happiness, the numbers of mankind would be increased and their condition bettered.—Thomas Jefferson.**

The Western Producers

Before closing the comment upon beet sugar it is due to say that the beet sugar producers of the Plains and Intermountain region of the West have an argument for their case which does not apply to the industry east of the Missouri river. They have a regional consumption demand which if supplied from the seaboard involves a long rail haul with freight charges which must be covered by prices in that territory. Moreover, climatic conditions are favorable to the largest possible sugar content in beets. In short, the industry in that region is on a different economic basis, to the extent of this local demand, from anywhere east of the Missouri river, and undoubtedly could live under a lower tariff, if not entirely independent of the tariff. In so far as this is true the foregoing comments are not intended to apply, but this portion of the industry has nothing to gain from a tariff policy which looks to spreading the industry over all of the country, under an artificial stimulus. When all imported sugars are eliminated, a purely competitive situation will exist in the domestic industry, and it is probable that an over-supplied situation will be found to exist. Moreover, the greater part of such an investment always will be subject to the risk of tariff reductions.

Sugar from the Philippines

When the Philippine Islands came under the sovereignty of the United States, the first tariff legislation affecting the entry of their products to this country established a general rate of 25 per cent off the levies upon importa-

tions from foreign countries. Later a limit upon imports of Philippine sugar was fixed at 300,000 tons per year. In 1913 Philippine sugar was made duty free and the limit taken off. After the war was over and this country's sugar duties were raised by the acts of 1921 and later, large sums went into the sugar industry in the Philippines for the express purpose of producing sugar for United States consumption. The production has increased steadily and in the crop year of 1932-1933 has amounted to about 1,150,000 long tons, with exports to the United States of over 1,000,000 tons. The increase of the Philippine supplies in this market necessarily has meant the exclusion of an equal quantity of the Cuban product. The Philippines are wanting their independence, but say that the loss of the United States market for their sugar will ruin their sugar industry, built up especially for this market.

Thus the policy of developing in the Philippines a sugar supply for the United States, in substitution for the Cuban supply, has been injurious to all the parties affected. It has been very costly to the consumers and Treasury of the United States, terribly disastrous to Cuba and now is a cause of perplexity and controversy among the Philippine people, and of prospective loss to the investors there and in Cuba. It has involved this country in the charge of acting in bad faith with both Cuba and the Philippines. Obviously it was a mistaken policy from the beginning.

American Investments Not Responsible

Representations that American investments and American business operations in Cuba have been responsible for the economic disaster which has befallen the Island, have no warrant in the facts. The reciprocity treaty seemed to afford the promise of a new era in Cuba, and foreign capital, chiefly from the United States, flowed into the Island as never before, in response to the applications and invitations of the Cuban people. Railroads were built, public utilities constructed or rehabilitated, the sugar industry was reconstructed and expanded, new industries were established, the cities were paved, provided with modern sanitation and adorned with fine business structures and public buildings. Naturally, property values increased, wages advanced and despite some vicissitudes the outlook for the future was promising until the great war came on with its worldwide effects.

A part of the American capital which went to Cuba took the form of loans to Cuban borrowers, but much more of it was employed in fixed investments under corporate ownership, in which in many instances Cubans participated to some extent by accepting securities for old properties, in whole or part. In other cases old enterprises were bought out for cash, and usually at prices that now seem very high. At the present time a very large amount of American capital appears to be hopelessly sunk in Cuba. It has met this fate in pursuance of a perfectly rational purpose to produce a great staple article of food as cheaply as it could be produced anywhere in the world and more cheaply than it could be produced in its natural market, the United States.

The foreign banks represented in Cuba—American, Canadian and others—went there to do the usual banking business, responding to the prospect that there would be need for increased banking facilities to handle the business of the Island. Anyone competent to write upon the subject at all should know that banks do not acquire real estate or industries if they can avoid it, and that the National bank act, of the United States, under which the New York banks were operating in Cuba, does not permit such investments. Unfortunately these banks have been obliged to take over from debtors certain plantations and other properties in Cuba, as thousands of banks have been obliged to take over farms and other properties in this country. Any representation that the banks have desired such acquisitions, or have any prospect of profiting by them is a travesty of the facts. No acquisition of this kind is included in the stated assets of this Bank.

The larger part of the public debt of Cuba has been incurred since the depression in sugar began, the expenditures being for public works and prompted in large part by the importance of affording work for the unemployed. Other countries have thought themselves justified in large expenditures for similar reasons. The loans for these purposes were not forced upon the Cuban government and there is no reason for representing the lenders as plunderers.

To sum up, the American investments in Cuba have been made for legitimate business purposes, were expected to increase the wealth and income of the Island, serve the needs of its people and serve the special needs of the trade between Cuba and the United States. Obviously the tariff upon sugar has affected American interests in Cuba the same as Cuban interests there.

It goes without saying that the tariff policy of the United States has not been determined by enmity or malicious intent toward Cuba, but by what the Government at Washington has conceived to be the interests of the people of this country. Nobody would claim that the interests of American investors or businesses in Cuba should prevail in such legislation over the interests of this country as a whole. The national policy should be determined upon broad considerations. The only criticism of the policy ever offered in this publication has been that the determination has been made

without proper consideration for all the conditions which have concerned the United States. The attitude of this Bank on the subject has been the same ever since the adoption of the reciprocity treaty. It accepted the policy so cogently advocated by President McKinley, President Theodore Roosevelt and Secretary Root, and has stood by it ever since, believing it to be in the interest of both countries.

Whether the tariff upon sugar would have been advanced as it has been, three times since the reciprocity treaty was adopted, if there had been no war, cannot of course be known, but probably not. The war resulted in the large production for this market in Porto Rico and the Philippines. It was the violent changes in the production and prices of sugar occasioned by the war which caused, first the extravagant rise of prices and then the extravagant rise of production and consequent fall of prices, followed by the defensive increase of tariffs in this and other countries with its final spur to production—which accomplished the ruin of Cuba.

In truth, the state of the sugar industry illustrates very clearly the general disorganization of industry caused by the war, all over the world. Moreover, the people of Cuba were just like the people everywhere else in assuming that the great industrial activity of the war-time and years following, with the accompanying rise of prices and wages, signified that a wonderful and permanent prosperity, unparalleled in all the past, had been born of the war, which would have been a violation of both reason and morality. All of the conditions of that time were abnormal and fictitious, but the people of Cuba were deceived by them and went into debt on the strength of them, just as did the people of the United States, and with similar results. The great lesson of the Depression is that war is an anachronism in modern life, that modern, highly organized, interdependent, society cannot afford to have war.

The World Sugar Situation

Reference has been made above to the destruction of about 70 per cent of the sugar-making capacity of Europe during the war, causing a rise of prices which stimulated an excessive development of new capacity. Thus the sugar production of the United States and its insular territories increased from about 2,000,000 tons at the end of the war to over 4,000,000 tons in the present year.

Japan and India had previously supplied less than one-half of their own consumption, obtaining the remainder from Java. Japan is now fully self-supporting (from the Island of Formosa) and is reported as exporting some sugar. The situation in India was described recently in the London Times as follows:

> Rapid developments of the sugar industry in India have produced a situation of international importance, according to the weekly trade letter of the Sugar Federation of the British Empire. That is the reason why the Government of India has called the conference reported in The Times on June 15, of sugar-growing States and Provinces which is to be held at Simla on July 10.
>
> In the 1931-32 season 30 factories were working in India, in 1932-33 some 27 new factories came into operation, and the federation has received information that 53 new factories are in course of construction for the present season, 1933-34. Calculating the prospective outputs of the 110 factories, the federation estimates that they are capable of a production this season of 950,000 tons, equal to the total Indian home and import requirements last year.

Italy, Spain and France, formerly importers of part of their supplies are now self-sustaining. One of the strangest cases is that of Great Britain which has expended about $100,000,000 in the last eight years in subsidizing the establishment of a beet sugar industry in England, although the cane sugar industry of its own colonies has been in dire straits. This policy of Great Britain toward its colonies has been identical with that of the United States toward Cuba, although the production of England has excluded Cuban rather than Colonial sugar from the home market, while contributing to the general excess.

In all, this post-war expansion of sugar production in the face of existing over-production has curtailed the aggregate of sugar exports to the amount of about 6,000,000 tons, Cuba and Java being the chief sufferers. It has destroyed the purchasing power of sugar-producers everywhere, as we have seen in the case of Cuba, not to speak of investments aggregating hundreds of millions. No single word describes the sugar situation so well as anarchy, and before anybody lays the responsibility of it upon the free system of industry governed by the law of supply and demand, we will repeat that it has all been fostered and directed by governments, in frank disregard of all economic law.

Moreover, the same policy is running rampant among the industries generally over the world, in violation of the principle of specialization and exchange which has been the principal factor in industrial and social progress. The volume of all trade has fallen about one-half in three years, owing to confusion in production and prices, caused primarily by the violent changes occasioned by the war. The situation has been as bad in domestic as international trade, owing to a similar disruption of trade relations. It is only stating the obvious truth to say that there can be no general restoration of employment and prosperity except by the restoration of the reciprocal and balanced exchanges by which the different population groups are able to obtain and consume each other's products. All of the improvements in industry and gains of mass production will come to nothing unless there is a reasonable degree of order and cooperation in production and exchange.

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